Rev. Rul. 76-402, 1976-2 C.B. 177

Unrelated income; summer tennis camp conducted on school campus. An exempt school annually contracts with an individual who conducts a 10-week summer tennis camp with the school furnishing the tennis courts, housing, and dining facilities and the individual hiring the instructors, recruiting campers, and providing supervision. The amounts received are from dual use of facilities and personnel; therefore, an allocable portion of expenses attributable to such facilities and personnel may be deducted in computing unrelated business taxable income under section 512 of the Code.

Advice has been requested whether, under the circumstances described below, the unrelated business income of a school that is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 derives from dual use of facilities and personnel within the meaning of section 1.512(a)-1(c) of the Income Tax Regulations or from exploitation of exempt activities within the meaning of section 1.512(a)-1(d). The question is relevant in determining the method of computing unrelated business taxable income under section 512 of the Code.

The school regularly carries on 'unrelated trade or business' as that term is defined in section 513 of the Code by annually contracting with an individual who conducts a ten-week summer tennis camp. For a fee, the school provides tennis courts, furnished dormitory rooms, linens, maid service, meals, and dining facilities for use by the individual in conducting the camp. These same facilities and personnel are employed during the regular academic year in the school's educational program. Under the contract, the individual is responsible for hiring tennis instructors, recruiting campers, conducting the tennis camp program, and supervising the conduct of the instructors and tennis patrons. Although the summer tennis camp is not part of the school's curriculum, the school's name is mentioned in the promotional advertising for the camp.

The term 'unrelated business taxable income' is defined in section 512 of the Code as the gross income, with certain modifications, derived by an organization from any unrelated trade or business regularly carried on by it, less allowable deductions which are directly connected with the carrying on of such trade or business.

Section 1.512(a)-1(c) of the regulations provides that where facilities or personnel are used both to carry on exempt activities and to conduct unrelated trade or business activities, the expenses, depreciation, and similar items attributable to such facilities or personnel are allocated between the two uses on a reasonable basis. The portion allocable to the unrelated trade or business activity may be deducted in computing unrelated business taxable income.

Section 1.512(a)-1(d)(1) of the regulations provides, subject to an exception set forth in section 1.512(a)-1(d)(2), That, where gross inome is derived from unrelated trade or business activity which exploits an exempt activity, the expenses, depreciation, and similar items attributable to the conduct of the exempt activities are not deductible in computing unrelated business taxable income.

Section 1.513-1(d)(4)(iii) of the regulations is applicable to situations in which an asset of facility used in the conduct of an exempt function is also used in a commercial endeavor. Gross income from the commercial endeavor is classified as gross income from the conduct of unrelated trade or business where such income is produced from an activity that does not contribute importantly to the accomplishment of an exempt purpose. To illustrate, the regulation provides an example of a museum that, during regular museum hours, shows educational films related to its exempt function in its theater. During the evening hours, it shows ordinary commercial pictures for an admission fee. The gross income produced during the evening hours is from unrelated trade or business and is derived from dual use of assets or facilities.

Section 1.513-1(d)(4)(iv) of the regulations is applicable to situations in which an organization has generated goodwill and other intangibles in the performance of its exempt activity that are exploited in a commercial endeavor that does not contribute importantly to the accomplishment of the organization's exempt purpose. The regulation illustrates this kind of income with an example of a scientific organization that has an excellent reputation in biological research and that regularly sells endorsements of various items of laboratory equipment. The selling of such endorsements does not contribute importantly to any of the organization's exempt purposes and the resulting income is classified as unrelated trade or business gross income derived from the exploitation of an exempt function.

In the instant case, the tennis camp's patrons are attracted to the school primarily for its capacity to provide suitable tennis facilities and personnel. Its reputation as an educational institution is of secondary importance, if a factor at all, in attracting the patrons. Thus, the school is not exploiting goodwill or other intangibles generated from the performance of its exempt function. The school is, however, using its educational facilities and personnel both for the accomplishment of its exempt purposes and for income-producing purposes that are unrelated to its exempt purposes.

Accordingly, the school's income from the summer tennis camp activity derives from dual use of facilities and personnel within the meaning of section 1.512(a)-1(c) of the regulations. Since dual use of facilities and personnel is involved, the allocable portion of expenses, depreciation, and similar items attributable

to such facilities and personnel may be deducted in computing unrelated business taxable income under section 512 of the Code.